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SENSITIVE

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SUBJECT: STATUS OF FORMER USG PROPERTIES IN THE PANAMA CANAL ZONE--A MIXED RECORD OF SUCCESS

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¶11. (SBU) Summary: Panama's Interoceanic Region Authority (ARI) is responsible for converting former USG property in the Panama Canal area to private and commercial use. It has had a number of significant successes, and current and future investment in these "reverted" areas could total \$2.5 billion. Even so, ARI is plagued by slow bureaucracy, accusations of corruption, and ham-handedness in planning, which have caused numerous investor disputes and complaints, while significant portions of the lands remain undeveloped. Despite its problems, ARI has certainly had a positive effect on Panama's economy, but much remains to be done in the remaining two years of its mandate. End Summary.

A Huge Development Goal: Former USG Facilities and Lands

¶12. (SBU) Charged with marketing former U.S. military bases in the former Canal Zone that reverted to the GoP under the terms of the 1977 Carter-Torrijos treaty and negotiating deals to convert them to productive civilian use, ARI manages 59,300 hectares of land (1 hectare equals 2.47 acres). Some 46,000ha are zoned and set aside for environmental protection and forestry projects. Of the remaining 13,300ha, 4,500ha are in housing developments and 8,800ha are commercially developable. ARI also controls 13,573 former USG structures, including 8,584 houses and 1082 commercially developable buildings, plus 3,907 "other" units such as storage tanks. There has been no clear methodology to calculate the total value of the structures, and overestimation of their functional value and investor interest led some experts to conclude in 1999 that the reverted areas' buildings were worth an improbable \$30 billion, though now the GoP uses a more modest \$5 billion figure, not accounting for depreciation.

ARI Has Made Significant Advances Converting the Property

¶13. (SBU) As of May 2003, private enterprise has invested or signed contracts to invest approximately \$1.5 billion in the reverted areas, with a projected additional \$1 billion more through 2006. The maritime industry leads the pack with \$771 million in current investment, followed by infrastructure projects at \$164 million and tourism at \$130 million. Businesses in the reverted areas employ 52,000 workers--a three-fold increase since the USG relinquished control of the Canal, according to ARI. In the maritime sector particularly, the new investment has had a significant impact. Container ports such as Manzanillo International Terminal (MIT- owned by Stevedoring Services of America) and Evergreen on the Atlantic side, and Panama Ports on the Pacific have all averaged more than \$200 million in investment with plans for more. Whereas in 1994 ports in Panama moved 400,000 containers, capacity in 2003 was 2.8 million, and capacity may reach 4 million containers by 2006. Investment in cruise ship ports on the Atlantic and Pacific entrances totals \$100 million. In the 2002-2003 season, a total of 145 cruise ships made port calls with 160,000 passengers visiting Panama.

¶14. (SBU) The City of Knowledge, based at the former Ft. Clayton, is a business and technology incubator. Currently some 40 companies focused on research, telecommunications, software development have set up shop there. In addition, Canada's McGill University grad school labs, UNICEF and UNDP regional headquarters, and the Smithsonian Tropical Research Institute have offices there. Companies on-site receive sizeable tax breaks, duty free import of goods, and exemption from income tax.

15. (SBU) Fort Amador at the Pacific entrance of the Canal is ARI's most visible and clearly successful project. It has seen \$140 million in investment so far, and the useable terrain is 90% occupied. In addition to the cruise ship port, the development includes four hotels, two marinas, multiple restaurants and shops plus a biodiversity museum partnered with the Smithsonian. A convention center that anchors the development was the site of the Miss Universe pageant this past May. But success doesn't stop there- the former Albrook air base is now Panama City's domestic airport as well as the home to a multi-million dollar international bus terminal. A new \$100 million shopping mall is about to open as well. Other facilities throughout the reverted areas include the ecotourism-based Gamboa Rainforest Resort, and the five-star Melia Panama Canal Hotel on the site of the former School of the Americas.

Unfortunately the Success Belies Serious Investment Problems

16. (SBU) Numbers work both ways, however. Almost all of ARI's success stories date from before the formal turnover in 1999 or immediately after. A key indicator of ARI's slowing success is its net revenue contribution to the GoP--income from concession fees and property sales minus operating costs and investments--which has totaled a paltry \$100 million from July 2000 to July 2003. Further, there were 323 property transfers for a total of \$40 million in 2000, but in the period January-July 2003, ARI approved only 48 property transfers worth a total of \$3 million--a mere fraction of the 2000 figure. By one estimate, 70% of the former USG housing lies vacant in a country where 41% of the population lives in poverty and in substandard housing conditions.

17. (SBU) Investors are generally critical of ARI's performance, complaining of bureaucratic delays and failure to follow through on investor interest. And though no smoking gun has ever been discovered, there are persistent charges that ARI officials are corrupt, requiring kickback "fees" on concessions that are approved. Symbolic of these difficulties, the Embassy currently monitors six separate U.S. investor disputes that involve ARI. For example, MIT--touted by ARI as a major success--has been trying to expand its operations by purchasing land adjacent to its current concession, but ARI has consistently overpriced the value of the property than its commercial value and has forced MIT to shelve the project. Florida State University, resident in Panama for over 40 years, has unsuccessfully sought to purchase its leased property from ARI. Again, reneging on a previous agreement with FSU, ARI revalued and overpriced the concession. As a result, FSU is seriously considering leaving Panama.

18. (SBU) In another project called the Bridge of the Americas Cultural Center, ARI delayed granting the concession to a U.S. investor for over two years, and even then in a much-reduced form, while prime areas of the original project were awarded to a relative of the current Colon Free Zone manager. ARI officials granted a marina concession at Ft. Amador that trespasses on a Ministry of Economy and Finance license that could potentially cause serious damage to Global Crossing's intercontinental fiber-optic cable and hinder telephone and internet connection between North and South America. Anecdotally, Econoffs have heard of individual homebuyers who have paid over half the value of the house they purchased and after several years of delays still do not have a title. The concerns are not isolated to foreign investors--ARI has asked the GoP's National Maritime Service (SMN) to move from its current site at the former Caribbean-side Ft. Sherman which ARI controls and views as a potentially lucrative tourism development. While negotiations are ongoing and the future SMN base will most likely be of similar size and utility, initially many worried that ARI was foregoing the importance of Canal security for economic expediency.

Expectations/Pressures Result in "Grand Scheme" Thinking

19. (SBU) Early successes have unfortunately led to unrealistic expectations about what ARI can accomplish and exacerbated pressure on ARI to produce visible results leading up to the 2004 Presidential elections. As a result, ARI has made a number of inconsistent decisions and resource allocations that appear more questionable than those made a few years ago. Indeed, ARI appears to favor a series of

"grand scheme" projects, while small projects are being rebuffed and hence no investment momentum is being created. As an example, ARI has taken an "all or nothing" approach to develop the former Howard Air Base for \$400 million.

¶10. (SBU) Tenders for Howard as one giant development have closed without bidders, and several other concepts for use have been stillborn. Only in March of this year did ARI succeed in attracting a Dell Computer Call Center to Howard as the anchor of a proposed multimodal-shipping hub. A GoP proposal on September 5 to the Legislative Assembly to turn to turn Howard into an Economic Development Zone has generated howls of protest from the Colon Free Zone about an unbalanced legal framework. Worsening the situation, ARI has approved construction of several high-rise buildings near Howard that could obstruct the landing approach to the airstrip on the former base, which could inhibit that aspect of development altogether.

COMMENT: Troubled victories, confused priorities, unclear future

¶11. (SBU) Clearly, the reverted areas have been an economic boon to Panama, and there is significant potential to develop the remaining areas that haven't been auctioned. In ARI's defense, no government agency could have been completely prepared for the massive tidal wave of property and infrastructure transferred just before the December 1999 handover. Further, some projects are very tough to adjudicate quickly, often needing to pass muster by multiple GoP agencies--valuations approved by the Comptroller, environmental impact statements by the Environmental Authority, port improvements by the Maritime Authority, etc. Even so, investor disgruntlement and accusations of corruption are tough to ignore. Current investors complain of serious problems and potential investors find their ideas ignored while ARI pursues grandiose development plans. It is important to remember that the revert areas include significant capital investments by the USG--investments that were handed to the GoP for free, and that any conversion to private hands is pure profit for ARI.

¶12. (SBU) Perhaps most importantly, ARI's mandate ends on December 31, 2005. With substantial land and infrastructure yet to be transferred to private hands, ARI would have much to accomplish in such a short period of time--a goal that it is unlikely to achieve. However, Panama's Legislative Assembly has made no move to extend the mandate, and ARI's future is unclear.

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